

Fixed Income Quotation Information and Alternative Trading Systems

FINRA Requests Comment on Proposal to Require Alternative Trading Systems to Submit Quotation Information Relating to Fixed Income Securities to FINRA for Regulatory Purposes

Comment Period Expires: April 7, 2015

Executive Summary

FINRA is soliciting comment on a proposal to require alternative trading systems (ATs) to submit quotation information relating to corporate and agency debt securities to FINRA solely for regulatory purposes. The proposed rule text is attached as Appendix A.

Questions regarding this *Notice* should be directed to:

- ▶ Patrick Geraghty, Vice President, Quality of Markets, at (240) 386-4973;
- ▶ Ola Persson, Vice President, Transparency Services (TS), at (212) 858-4796;
- ▶ Elliot Levine, Associate Vice President and Counsel, TS, at (202) 728-8405;
- ▶ Lisa Horrigan, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8190; or
- ▶ Alex Ellenberg, Assistant General Counsel, OGC, at (202) 728-8152.

February 2015

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Fixed Income
- ▶ Legal
- ▶ Operations
- ▶ Systems
- ▶ Trading
- ▶ Training

Key Topics

- ▶ Alternative Trading Systems
- ▶ Fixed Income
- ▶ Quotation Information

Referenced Rules

- ▶ FINRA Rule 0150
- ▶ FINRA Rule 5220
- ▶ FINRA Rule 5310
- ▶ FINRA Rule 6710
- ▶ Securities Act Rule 144A
- ▶ SEC Rule 300

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by April 7, 2015.

Comments must be submitted through one of the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.¹

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).²

Background and Discussion

Electronic markets for fixed income instruments are growing. This expansion of electronic markets includes the use of alternative trading systems for retail size bond orders. Currently, FINRA member firms are not required to routinely make available quotation information for fixed income securities for either regulatory or dissemination purposes. As a result, unlike the listed equities markets where FINRA receives consolidated information on quotations and trades, FINRA does not have ongoing access to quotation information for fixed income securities.

To inform FINRA's regulation of and strengthen its ability to surveil fixed income trading, FINRA is requesting comment on a proposal to require ATs to submit to FINRA for regulatory purposes quotation information for corporate and agency debt securities.

Under the proposal, fixed income quotation information reported to FINRA would not be publicly disseminated and would be used solely for regulatory and surveillance purposes.

Scope of the Proposed Reporting Requirement

The proposed reporting requirement would apply only to ATSs that display quotations in fixed income securities. FINRA recognizes that there are other significant electronic fixed income trading platforms that are not ATSs; however, it believes that initially limiting the proposed reporting requirement to ATSs is a clear, measured step that will capture useful data, particularly for retail size trades, that will be informative both for surveillance purposes and for purposes of analysis of the potential value and feasibility of public dissemination in the future. A broader proposal that would include, for example, request for quote (RFQ) platforms that are not ATSs, do not carry actionable quotes, and service more of the institutional and inter-dealer market may potentially be more complex and burdensome for firms from a reporting standpoint.

Under the proposal, ATSs would be required to provide FINRA with quotation information only for TRACE-eligible corporate and agency debt securities.³ ATSs would not be required to provide quotation information for other fixed income products such as securitized products (*e.g.*, mortgage- and asset-backed securities).⁴ An ATS would be required to report all quotation information that it displays to its general subscriber base or a subset of its subscriber base, including all updates to such quotations, made on a real-time or other basis. For purposes of the proposed reporting requirement, “quotation” includes both “subject” (*i.e.*, the price is subject to confirmation) and firm⁵ quotes (including those identified as eligible for automatic execution) and thus would be defined generally as any offer to buy from or sell to any person or entity at a specified price, yield or spread, including any priced orders that may be displayed on behalf of a customer.⁶ An ATS that conducts an RFQ business would not be required to report quotation information resulting from the RFQ process, where the quote provided is intended only for the requesting party and not a broader set of subscribers.

The specific quotation information that an ATS would need to report under the proposal would include the identity of the party submitting the quote (or an indication that the submitting party is a non-member) and the party’s capacity (*i.e.*, agent or principal, if capacity information is conveyed to the ATS); the CUSIP or FINRA symbol of the quoted security; the date, time, and duration (if applicable) of the quote; the actual or minimum size associated with the quote; the price, yield, or spread to benchmark (including information on the relevant benchmark) of the quote as it was submitted by the party to the ATS; the quote as displayed to the ATS subscribers, whether the quote was “subject” or firm; the side of the quotation (buy or sell); and whether the quote was modified or cancelled, and if so, the date and time of the modification or cancellation.

ATSs would need to report this quotation information to FINRA on a weekly basis. Accordingly, an ATS would be required to report by the end of week 2 all quotation information for the prior week 1. Because the data will be provided to FINRA for regulatory and post-trade date surveillance purposes only, FINRA does not believe that real-time reporting is warranted under the current proposal.

Finally, in connection with this *Regulatory Notice* comment process, FINRA may determine to request that ATSS provide a limited amount of historical quotation information (*e.g.*, for a specified period of months or a designated quarter) on a one-time basis, to help inform the rulemaking process (*e.g.*, by identifying additional data elements to be reported).

Economic Impacts

Anticipated Benefits

The proposed reporting requirement would strengthen FINRA's overall regulation, and particularly its automated surveillance of fixed income trading by providing additional information on prevailing market conditions. FINRA may detect compliance violations and potentially manipulative behaviors in fixed income instruments more effectively with the assistance of the quotation data. The proposed reporting requirement would also enable FINRA to study the data submitted by ATSS to assess the existing information available to ATS subscribers and to more fully explore the implications of the differences between the fixed income and equity markets.

Anticipated Costs

FINRA recognizes that the proposed reporting requirement would require ATSS to establish a process (*e.g.*, file transfer protocol) through which to submit quotation information to FINRA. Thus, ATSS would potentially be subject to a one-time development cost, as well as ongoing costs for operational support and monitoring for compliance (*i.e.*, to ensure that the submissions meet the requirements under FINRA rules). FINRA anticipates leveraging its existing infrastructures for the transmission of data to FINRA to minimize the impact and costs on firms and FINRA. FINRA encourages commenters to provide estimates of the potential costs associated with the proposed reporting requirement. FINRA also requests comments on the proposal's potential indirect impact on liquidity and market participation.

Request for Comment

FINRA requests comment on all aspects of the proposed reporting requirement, including any impact on investors, fixed income trading platforms, or market makers. In addition, FINRA specifically requests comment on the following issues:

- ▶ Do commenters believe the scope of the proposed reporting requirement is appropriate?
 - ▶ Should FINRA consider broadening the reporting requirement to collect quotation information from other fixed income trading mechanisms, such as RFQ platforms? If so, what other entities should be included, and why, and how should such quotation information be collected?

- ▶ FINRA understands that some quotations displayed through an ATS may not be displayed to all subscribers, but only to a subset of the general subscriber base. How common is that practice? How are those sub-groups determined?
- ▶ FINRA is proposing to initially require quotation information for corporate bond and agency debt securities. Should the scope of the proposed reporting requirement be expanded to include securitized products? To what extent would an expansion of the reporting requirement to all TRACE-eligible securities impact an ATS's compliance costs?
- ▶ Would the proposed reporting requirement potentially have unintended consequences, such as on a fixed income trading platform's willingness to commence and continue operating as an ATS? Similarly, would the exclusion of RFQs from the scope of the proposal impact firms' quoting behavior?
- ▶ What would be the potential costs to ATSs of the proposed reporting requirement?
 - ▶ How many ATSs would be subject to the proposed reporting requirement?
 - ▶ Would there be a one-time development cost to build a reporting mechanism? If so, how much would it be?
 - ▶ In addition to potentially incurring a one-time development cost to build a reporting mechanism, what ongoing costs may an ATS incur, *e.g.*, for operational support, monitoring and compliance? How much would the costs be?
 - ▶ Would the costs be different for ATSs with different sizes or business models?
 - ▶ Are there any alternative approaches that FINRA should consider that may lessen compliance costs?
- ▶ In what form do ATSs maintain quotation information today, and for what period of time? Is the information that ATSs would be required to report for each quotation currently maintained in an automated format? If not, what systems changes would be required to compile and report the information? What would be the associated costs?
- ▶ As noted above, FINRA is proposing to require ATSs to report one week's quotation information by the end of the following week. Would ATSs want the option of submitting quotation information on a real-time or near real-time (*e.g.*, end of day or next day) basis rather than weekly batch submissions?
- ▶ To what extent would a requirement to report quotation information to FINRA more frequently than each week, for example on a real-time basis or next-day basis, affect a firm's costs to comply?
- ▶ ATSs would report to FINRA, among other things, the identity and capacity of the party that submitted the quote to the ATS if it is a FINRA member firm or an indicator, but not the specific identity, when the submitting party is a non-FINRA member firm. Are there any challenges with identifying these elements for reporting purposes? Is there any additional information that should be collected concerning identity or capacity?

FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible.

Endnotes

1. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments) for more information.
2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.
3. The terms “TRACE-Eligible Security” and “agency debt security” are defined in FINRA Rule 6710(a) and (l), respectively. The term “corporate debt security” would be defined in proposed Rule 45XX(a)(3).
4. The term “securitized product” is defined in FINRA Rule 6710(m) (effective April 27, 2015).
5. FINRA Rule 5220 generally prohibits members from making an offer to buy from or sell to any person any security at a stated price unless such member is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell. The Supplementary Material further provides that under normal circumstances where the member is making a “firm trading market” in any security, it is expected at least to buy or sell a normal unit of trading in the quoted stock at its then prevailing quotations unless it is clearly designated as not firm or firm for less than a normal unit of trading when supplied by the member.

FINRA notes further that nothing in this proposal, including discussion of whether quotations are “subject” or firm, is intended to inform or otherwise impact the SEC’s definition of the term “order” in SEA Rule 3b-16 or SEC Regulation ATS.
6. Quotations or expressions of interest that do not communicate a specified price would not be covered by this proposal.

APPENDIX A

Below is the text of the proposed rule change. Proposed new language is underlined.

4000. FINANCIAL AND OPERATIONAL RULES

* * * * *

4500. BOOKS, RECORDS AND REPORTS

* * * * *

4550. ATS Reporting

* * * * *

45XX. Requirements for Alternative Trading Systems to Submit Quotation Information for Fixed Income Securities

(a) Within seven business days after the end of each week, each member that has a Form ATS on file with the SEC shall report to FINRA solely for regulatory purposes, in such format as FINRA may require, Quotation Information displayed by the ATS to its general subscriber base, or a subgroup of its general subscriber base, during the previous week for the following securities:

- (1) corporate debt securities; and
- (2) agency debt securities.

(b) Definitions

For purposes of this Rule, the term:

- (1) “agency debt security” has the same meaning as in Rule 6710(l);
- (2) “ATS” has the same meaning as the term “alternative trading system” as defined in Rule 300 of SEC Regulation ATS;
- (3) “corporate debt security” means a debt security that is United States (“U.S.”) dollar-denominated and issued by a U.S. or foreign private issuer and, if a “restricted security” as defined in Securities Act Rule 144(a)(3), sold pursuant to Securities Act Rule 144A, but does not include a Money Market Instrument as defined in Rule 6710(o);
- (4) “quotation” means any offer to buy from or sell to any person or entity at a

specified price, yield, or spread, including any priced orders that may be displayed on behalf of a customer, and includes both “subject,” i.e., the price is subject to confirmation, and firm quotes, including those identified as eligible for automatic execution.

(5) “Quotation Information” shall include for each quotation:

(A) the party submitting the quotation (or an indication that the submitting party is a non-member) and the party’s capacity (i.e., agent or principal, if capacity information is conveyed to the ATS);

(B) the CUSIP number or FINRA symbol of the quoted security;

(C) the date, time, and duration (if applicable) of the quotation;

(D) the actual or minimum size associated with the quotation;

(E) the price, yield, or spread to benchmark, including information on the relevant benchmark, of the quotation as it was submitted by the party to the ATS;

(F) the quotation as displayed to ATS subscribers;

(G) whether the quotation was “subject” or firm;

(H) the side of the quotation (buy/sell); and

(I) whether the quotation was modified or cancelled and if so, the date and time of the modification or cancellation.

••• Supplementary Material: -----

.01 For purposes of compliance with this Rule, each member that has a Form ATS on file with the SEC must report Quotation Information as it was provided to the ATS by the subscriber and as it was displayed by the ATS (e.g., a calculated price where the subscriber submitted a spread and inclusive of any fees added by the ATS). Quotation Information does not include the “request for quote” process, where the quote provided is intended only for the requesting party and not a broader set of subscribers.

* * * * *